Financial Stability Governance and Central Bank Communications

Discussion: Londono, Stijn & Correa

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Framework: structure, conduct, performance (by LCC)

- Structure:
  - CB is member of FS committee
  - Comittee has power to implement policy
  - CB has FS mandate
  - CB regulates domestic banks

- Conduct:
  - a policy function
    $f : (structe, state_t, information) \Rightarrow communication, instruments$

- Performance:
  - objective function: $g : f(\cdot) \Rightarrow state_{t+1}$

- Research question: does f maximize g?

- Message space (an index of pessimism)

$$FSS = \frac{\#negatives - \#positives}{\#total}$$

  - dictionary: 391 words, 96 positives, 295 negatives
  - Greenspan: "If I've made myself too clear, you must have misunderstood me"

- Main interest

$$\left. \frac{\partial \left(\frac{\partial\ state}{\partial\ instrument} \right)}{\partial\ FSS} \right|_{structure,\ state,\ information}$$

- Draghi's (2015): the "within our mandate, the ECB is ready to do whatever it takes ... believe me it will be enough"

CB vs. NS (II)
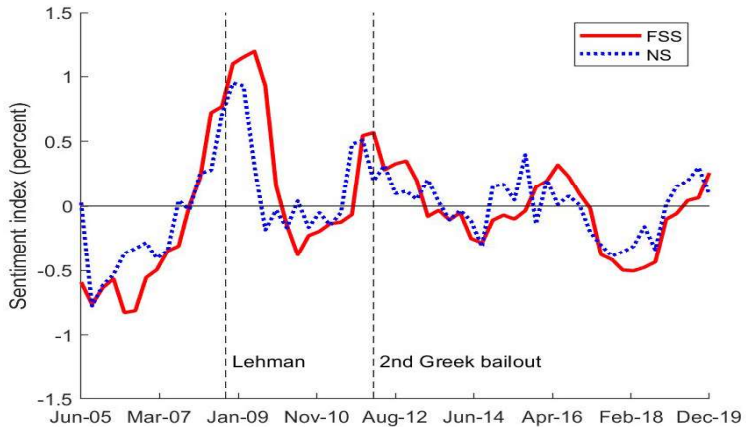
- Table 11:

$$FSS_{i,t+1} = \alpha_i + (\beta_1 + \beta_2 D_{i,t-1})\, NS_{i,t} + e_{i,t+4}$$

	Committee	Official committee
Constant	0.65***	0.65***
	(0.04)	(0.05)
NS (β_1)	0.57***	0.56***
	(0.06)	(0.06)
D*NS (β_2)	-0.20*	-0.27**
	(0.08)	(0.08)
$\beta_1 + \beta_2$	0.33***	0.28***
	(0.04)	(0.04)
R^2	0.17	0.18
N	1660.00	1660.00

"...which would provide support to the strategic use of communication by central banks"

- Because the CBs know that they will take action and soften the effect?
    - unlikely: the newspapers know the what powers the CBs have and incorporate their policies into their NS chatter

- Alternatively, the CBs worry that high FSS would trigger a crisis
    - if they talk about crisis they will be blamed for it
    - the Greenspan strategy

News effect and blame

Who do you think is most to blame for petrol stations running out of fuel?

All adults (3361 GB adults - Sep 28, 2021)

The government	**23**%
The public	**22**%
The media	**47**%
Other	**1**%
Don't know	**6**%
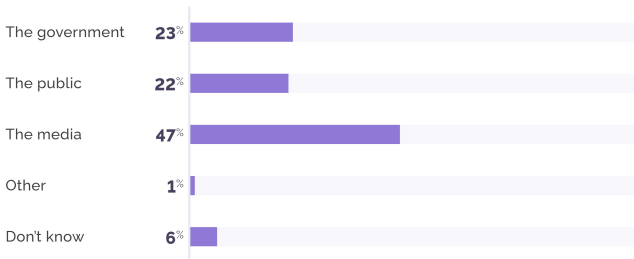
YouGov | What the world thinks   yougov.co.uk

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Weak FS-FSS correlations (I)

- Table 6:

$$FS_{i,t+4} = \alpha_i + \alpha + (\beta_1 + \beta_2 D_{i,t-1})\, FSS_{i,t} + \gamma FS_{i,t} + e_{i,t+4}$$

Panel A. Credit-to-GDP gap

	Homogeneous
AR coefficient	0.91***
	(0.03)
Constant	0.01
	(0.48)
FSS (β_1)	-0.45
	(0.47)
D*FSS (β_2)	
$\beta_1 + \beta_2$	
R^2	0.82
N	1594.00

- Table 9:

$$Pr\left[TP_{i,t+4}=1\right]=\Phi\left[X_{i,t}\beta\right]$$

	Committee	
	Yes	No
Constant	-1.71***	-1.67***
	0.09	0.09
FSS	0.05	0.26**
	0.13	0.10
R^2	0.00	0.03
N	1140.00	906.00

- Some light can be shed by the regression

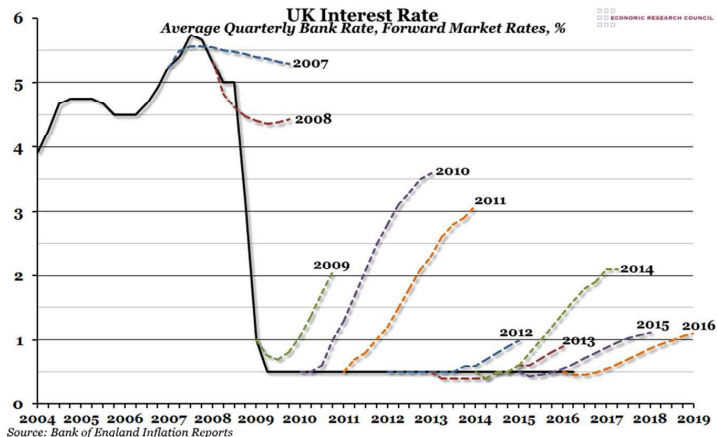$$FS_{i,t+4} = \alpha_i + \alpha + (\beta_1 + \beta_2 D_{i,t-1}) NS_{i,t} + \gamma FS_{i,t} + e_{i,t+4}$$

  and

$$Pr[TP_{i,t+4} = 1] = \Phi[X_{i,t}\beta]$$

  where NS replaces FSS in X

- Hypothesis: NS predicts FS equally well across Ds

- Table 14:

$$FS_{i,t+4} = \alpha_i + \alpha + (\beta_1 + \beta_2 D_{i,t-1}) FSS_{i,t} + \beta_3 MP_{i,t} + \beta_4 IR_{i,t} + \gamma FS_{i,t} + e_{i,t}$$

	Credit-to-GDP gap	Credit Growth	Debt service ratio
AR coefficient	0.92***	0.17**	0.59***
	(0.06)	(0.05)	(0.09)
Constant	-3.60**	0.09	4.95**
	(1.28)	(1.15)	(1.30)
FSS (β_1)	0.81	0.42	0.23
	(0.60)	(0.38)	(0.12)
D*FSS (β_2)	-1.52*	-1.38*	-0.22*
	(0.57)	(0.50)	(0.09)

- Table 16:

$$Pr[TP_{i,t+4} = 1] = \Phi[X_{i,t}\beta]$$

	Committee	
	Yes	No
Constant	-1.45***	-1.69***
	0.11	0.10
FSS	-0.05	0.29**
	0.14	0.09
MP	0.05**	0.03
	0.02	0.04
IR	0.00	0.05**
	0.01	0.02
R^2	0.02	0.05
N	500.00	496.00